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The Hon Stephen Jones MP
Assistant Treasurer
House of Representatives
Parliament House
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By email: Stephen.Jones.MP@aph.gov.au, PreBudgetSubmissions@treasury.gov.au

Dear Assistant Treasurer,

2023-24 Pre-Budget Submission

The Corporate Tax Association (**CTA**) welcomes the opportunity to make a submission in relation to the upcoming 2023-24 Federal Budget.

The CTA is the key representative body representing 151 major companies in Australia on tax issues impacting the large corporate sector. A list of CTA members is attached as Appendix 1. Further information about the CTA can be found on our website at www.corptax.com.au.

The CTA's focus is on ensuring the tax laws (in particular those applying to large corporates), and their administration are as efficient and competitive as practicable. We recognise the constraints on public finances and short and medium-term cost of living pressures that will underpin policy decisions taken in the May 2023 Federal Budget. Our focus in this submission is on the revenue side of the budget settings rather than spending and has considered the recent Parliamentary Budget Office publication on fiscal sustainability.[1]

With this in mind, the CTA suggests that the Government needs to address fiscal sustainability via the following avenues:

1. In the medium term, taking on the political challenge of the unsustainability of the current tax architecture via the following:

    - Addressing our overreliance on income tax;
    - Reviewing the basis and viability of tax expenditure concessions such as the capital gains discount.

   In this regard, we suggest a national conversation on developing medium term consensus on the direction of tax reform.

2. In the short term, encourage capital deepening and address areas of uncertainty in the tax system.

[1] See Beyond the budget 2022-23: Fiscal outlook and scenarios – Parliament of Australia (aph.gov.au).

1. A National Conversation on Tax Policy Settings

The October 2022-23 Budget saw decisions taken to give effect to election promises and improve the integrity of the tax system, with proposed amendments to the thin capitalisation regime, tax transparency and a commitment to implementing OECD Pillars One and Two. Other Budget measures included increasing ATO resourcing to address non-compliance and various imputation integrity rules. We submit that once these measures are implemented, concerns around large corporates 'not paying their fair share of tax' have been addressed, both in terms of strengthening the integrity of the corporate tax system and adequate resourcing of the ATO. Now, more than ever, it is incumbent upon the Government to take 'whole of system' forward-looking steps in its tax and revenue policy settings.

In this regard, the focus of the May 2023 Budget should be on developing an Australian tax system that is fit for the 21st century and beyond.

Numerous reviews of the Australian tax system have been undertaken in the past, and directionally all indicate a need to address the policy tax mix as a matter of economic efficiency and equity.[2] We submit that the issue is not that we do not know what needs to be addressed with our tax system but rather how to get there.

In our view, building national consensus on tax policy change is key and should start with a national tax summit where issues are raised, and an inclusive plan developed, to address our tax policy infrastructure. While we recognise this is easier said than done, a tax summit is in our view an important first step in developing a plan for medium and long tax system change.

2. Encouraging Capital Deepening

The current temporary full expensing measure (**TFE**) is due to expire on 30 June 2023. While it seems clear the TFE measure has encouraged some acceleration of capital spending, its temporary nature relative to the long lead time for making large-scale capital investments has probably made the measure fall short of expectations. Also, impacting the outcome of the measure was its design to only apply to certain groups with turnover below $5 billion and to only apply to new assets and not improvements to existing assets.

In our view, there is a strong case for making TFE a permanent feature of our tax system. It should not be forgotten that any tax depreciation acceleration is timing in nature and should not adversely impact government revenues in the medium term.[3] If short-term budget constraints remain a concern, extending the availability of the TFE by an additional three years to expenditure incurred before 30 June 2026 should stimulate additional investment.

Alternatively, if extending the TFE to all asset classes is not regarded as an option, consideration should be given to rules (such as those that apply in the UK and Belgium) that provide for full expensing in the year incurred (or some other form of accelerated depreciation) for new electric or hybrid vehicles as a permanent feature

[2] For example, the Henry review

[3] We recognise this may impact the budget outcome in the short term.

of our tax rules as a means to reduce carbon dioxide emissions[4]. Outside of electricity generation and stationary energy, transportation is the largest source of carbon dioxide emissions in Australia. Cars make up 45% of all transport emissions.[5] Many European countries effectively exempt the provision of such vehicles to employees from income tax and/or provide concessional registration taxes[6]. While the newly implemented FBT discount on certain electric vehicles available over the next three years (at this stage) goes some way to addressing this, its stimulus effect will be temporary and limited.

Other jurisdictions are also taking steps to attract and retain capital investment, for example, the new US *Inflation Reduction Act* has retained accelerated depreciation. Australia should bear such changes in mind if it wishes to remain competitive on the world stage for attracting and retaining capital investment, particularly for investment in green technology.

If budgetary constraints preclude the extension of the TFE, it is suggested some other form of investment allowance (**IA**) or accelerated depreciation should be considered as a means to encourage capital deepening. These can be achieved using the existing law framework (e.g. by introducing new statutory capped lives for new green energy assets or accelerating depreciation in the early years of the effective life of an asset). As these are 'timing' differences only, there should be little impact on the budget in the medium term.

3. Addressing Uncertainty - Outstanding Policy Issues

It is well-known that outstanding policy issues, essentially policy matters that have been announced but not yet progressed into the law, create unnecessary uncertainty for taxpayers who are caught in limbo between the existing (known) law and a policy announcement that potentially changes the law. There are other issues that the ATO is in process of trying to develop guidance for where the clear solution is a legislative amendment rather than an unclear administrative guidance.

A number of these issues are listed below which we believe should be addressed in the Budget and acted upon shortly thereafter. Action taken on these matters will alleviate uncertainty and reduce compliance costs.

a) Corporate residency

Following a comprehensive review[7] by the Board of Taxation in 2019 following which the Board recommended legislative amendments be made to the 'central management and control' test, the previous government announced[8] in the 2020-21 Federal Budget that technical amendments would be made to clarify the corporate residency test.

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[4] In the UK, EV and plug-in hybrid vehicles with CO2 emissions below 50 g/km are currently eligible for 100% write-down in the first year. To qualify, the vehicle must be brand new. EVs are also not subject to benefit in kind tax for company vehicles. The impact is similar to exempting in kind benefits from FBT. Company car benefit – the appropriate percentage (480: Appendix 2) - GOV.UK (www.gov.uk)

[5] See Australia's emissions projections 2021 | Department of Industry, Science, Energy and Resources chart_data.xlsx (live.com)

[6] See also EV_incentives_overview_2018_v2.pdf (acea.auto)

[7] https://taxboard.gov.au/consultation/corporate-tax-residency-review

[8] Refer to the measure 'Clarifying the corporate residency test' in the 2020-21 Federal Budget.

At this stage, draft legislation has not been prepared and this is creating unnecessary angst for corporate groups.

The issue has become more urgent since the ATO confirmed that the transitional compliance approach afforded to taxpayers in PCG 2018/9[9] will not be extended beyond 30 June 2023. The transitional compliance approach allows a foreign-incorporated company to rely on the now withdrawn TR 2004/15[10] to not be regarded as a tax resident of Australia.

We would urge the government to action the previous government's announcement as soon as possible.

b) Legislative clarity on the tax treatment of capitalised labour costs

We strongly suggest the Government consider providing legislative certainty on the circumstances in which labour costs (typically direct and indirect salary and wages and other related indirect costs such as payroll tax, maternity leave, and similar leave entitlements) will be deductible where such costs are directly or indirectly related to the construction and creation of capital assets.

Draft Taxation Ruling TR 2019/D6 Income Tax: application of paragraph 8-1(2)(a) of the Income Tax Assessment Act 1997 to labour costs related to the construction or creation of capital assets, which was issued in late 2019, is still in draft over three years later, consequently creating ongoing uncertainty around the correct treatment of these expenses.

The Australian Taxation Office (**ATO**) website notes "[w]e recognise that determining the capital/revenue distinction can, in some circumstances be difficult, and we will continue to work through the feedback received prior to finalising the Ruling. In the meantime, if you have any questions or have uncertainties in your position, you can ask us for private advice or other guidance that explains how the law applies to your particular circumstances."

We are aware of a number of significant ATO audits that have been subject to this compliance position. While audits on complex areas of tax law do and should occur, those that are being undertaken in this area have not only generated significant compliance costs for the taxpayers concerned, but also remain unresolved. Such a position is untenable, particularly given the treatment of capitalised labour costs is not a bespoke/industry-specific issue applying to large capital projects. We are aware of cases where the compliance burden, coupled with the onus being on the taxpayer to prove the correct allocation of costs, have made it extremely difficult for the taxpayer to discharge the onus. Such uncertainty has come at an extremely high cost, with both taxpayers and the ATO spending many millions of dollars in advisory fees.

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[9] See Practical Compliance Guideline PCG 2018/9 Central management and control test of residency: identifying where a company's central management and control is located.

[10] See Taxation Ruling TR 2004/15 Income tax: residence of companies not incorporated in Australia - carrying on business in Australia and central management and control (withdrawn in 2017)

A simple solution would be to introduce rules that extend the principles of full deductibility for salary and wage costs (and on-costs) regardless of whether an employee is working directly or indirectly on a capital project to equate with rules that apply to superannuation contributions under section 290-60 of the *Income Tax Assessment Act 1997*. Deductions would still be denied for expenditure incurred in generating exempt income.

The cost of such an amendment would be of a timing nature only and would better reflect the economics of capital projects by removing some of the economic distortion caused by requiring certain costs to be capitalised. It would also significantly reduce (if not remove) the cost of compliance for all taxpayers, including those that have not yet been subject to ATO scrutiny on the treatment of capitalised labour costs.

c) Changes to the treatment of FBT on car parking benefits

Corporate taxpayers require clarification of the treatment of certain car parking benefits for FBT purposes.

This issue has been fraught with difficulty since the handing down of the decision in *FCT v Qantas Airways Ltd* [2014] FCAFC 168 which created tension with the administration of the current 'car parking fringe benefits' rules in the *Fringe Benefits Tax Assessment Act 1986* (**FBT Act**). The tension arises between the original policy intent of the car parking fringe benefits rules, which was to impose fringe benefits tax on 'valuable car parking facilities - mainly in central business districts - that are provided by employers to their employees[11],' and the position in *Qantas* which has been interpreted to expand the concept of commercial parking station beyond commercially operated parking stations in a CBD as originally contemplated.

The ATO has finalised its position in [Taxation Ruling TR 2021/2 Fringe Benefits Tax: car parking benefits] which draws on the *Qantas* decision and expands the concept of 'commercial parking station[12]'. When applied, it potentially encompasses parking facilities provided by employers within a one kilometre radius of public and private hospitals, shopping centres and universities beyond parking stations located in a CBD as originally contemplated by the FBT Act.

We submit the Government should ensure the original policy intent of the rules is re-enforced and that FBT is imposed only on traditional standalone car parking facilities located in CBDs.

d) Reform of the consolidation rules following the Board of Taxation's review of CGT rollovers

We support the review the Board of Taxation is undertaking of the CGT rollover rules, including demergers and scrip-for-scrip rollovers. While it is prudent to await the outcome of the review and the Board's recommendations, in our view there is merit in ensuring the review considers the interaction of other tax rules with the rollover provisions, particularly as they relate to the interaction with tax consolidation and the employee share scheme rules.

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[11] See the Second Reading Speech to the *Appropriation Bill (No. 1) 1992-93* (Cth) in the House of Representatives on 18 August 1992 at p60 for the 1992-93 Federal Budget by the then Treasurer, the Hon John Dawkins MP.

[12] With effect from 1 April 2022

The current rollover rules when interacting with other tax rules have unintended consequences, notably impacting the reset value of assets on the consolidation event. The current rules also appear to convert shares given to employees as part of an employee share scheme to be on capital account, whereas had the demerger not occurred, any gain made would be taxed as income to the employee on disposal. These unintended consequences need to be addressed.

e) Aligning tax provisions for insurance with new insurance accounting standard

IFRS 17 Insurance Contracts was implemented on 1 January 2023. The updated accounting standard significantly impacts the financial reporting of insurance contracts.

Existing tax laws dealing with insurance contracts, such as Division 321 in the *Income Tax Assessment Act 1997* which deals with general insurance, contain a method statement that broadly aligns tax outcomes to the then existing accounting standard. It is submitted that these provisions should be updated for the new accounting standard. Without tax law changes, the general insurance industry, in particular, will have to maintain a separate set of accounts for tax purposes which creates a compliance burden for both taxpayers and the ATO, and inherent risk around data integrity, without any change to the level of tax payable over the life of an insurance contract.

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Should you have any questions in relation to the above, please do not hesitate to contact Paul Suppree on 0408 185 050 or Stephanie Caredes on 0408 028 196.

Yours sincerely,

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